

August 17, 1961

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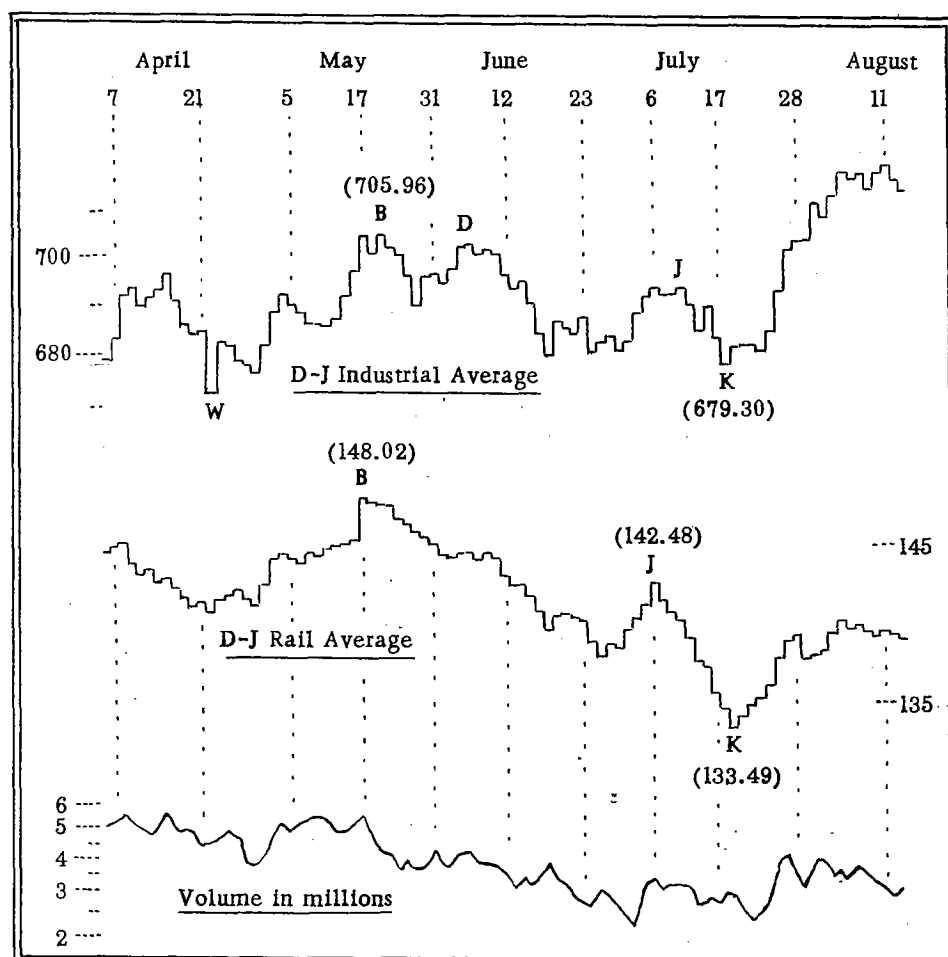
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THE MARKET Between July 18 and August 11 the D-J Industrial Average advanced 43 points. This represents an extremely sharp rally for only eighteen days of trading action. Over the same period Rails advanced 7 points, but it is important to note that the Rails have not as yet been able to hurdle their first minor peak at J (142.48). Thus we have a new all-time high on the Industrial Average unconfirmed by the transportation Average. From the standpoint of Dow's Theory, the situation would look a good deal healthier (1) if Rails had confirmed the advance by working steadily towards and then over their March 22 peak of 150.81, (2) if volume had been more convincing as the Industrials marched into new high ground.

On the plus side -- July 11 saw the advance-decline ratio (see Letter 152) rise above its minor peak of July 6. Thus, although the general market has been lagging far behind the fast-moving Industrial Average it has at least been trying to move in direction. Secondly, odd-lot transactions suggest that the public is growing cautious again, and there have been several days of actual odd-lot selling during the past week.

It would be normal to witness a one-third to two-thirds correction of the recent rather violent advance. Such a correction (if it is to be a healthy one) might see Industrials holding at about the 708 to 694 level with volume contracting sharply on the decline. Obviously, a decline which violated the preceding lows at K (Industrials 679.30, Rails 133.49) on heavy volume would be a danger signal well worth heeding.

CONCLUSION: The advance (so far) lacks authority. The five-day moving average of new highs touched a peak of 63 on August 8 (against 147 on March 4). The advance-decline ratio did not confirm the new high on Industrials. Volume expanded with higher prices but trailed off as the peak prices were seen (see chart).



The primary trend remains bullish. The secondary trend was last confirmed as bearish but will be considered bullish if Rails bettered 142.48 (J). I continue to feel that subscribers should exercise caution, and trading commitments should be confined only to the strongest stocks in the D-J Industrial Average.

CHECKING THE PRIMARY TREND One of the most important principles of Dow's Theory states that the primary trend or great tidal movement continues in force until proved otherwise. When stocks are "too high", when yields drop under 3% (as they did last week on the D-J Industrial Average), when technical indications imply weakness, we are entitled to become suspicious and to lighten up. No one can argue with a man who wants to take profits and pay the cost of "insurance" against a possible major decline or collapse. No one can argue with a man who sells because his portfolio position interferes with his nightly sleep. Moreover, Hamilton and Rhea never suggested holding stocks until the final proof of a reversal from bull to bear market was at hand.

Letter 151 noted that "clues as to the primary direction can sometimes be gathered by examining what the market has not done." Letter 151 also drew attention to the fact that in the vast majority of cases, once the final bull market peak has been recorded, stocks "fall away" in no uncertain fashion. Readers may well ask: "How far must stocks fall before we can be certain that the back of a bull market has been broken?"

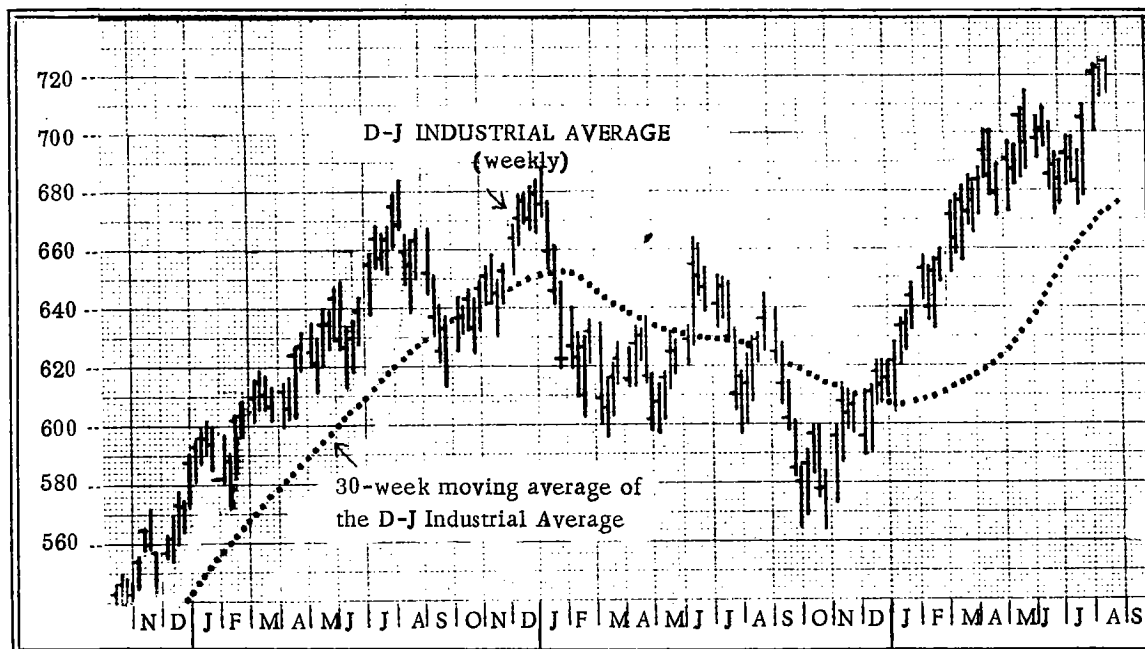
Aside from critical preceding levels in the Averages (and of course, violations of important levels provide the earliest important signals), the best answer is that during bear markets (and some severe secondary reactions) the Industrial Average always plunges through its own long-term moving average. I have kept a 30-week moving average of the D-J Industrial Average, and as the years pass I have put more and more faith in the reliability of this indicator. I have also made mistakes in my interpretations of the relationship of the Industrial Average and its own 30-week moving average, but with each mistake something new has been learned.

For instance, at important bull market tops there is seldom more than a two or three week hesitation before the Industrial Average plunges through its moving average (M. A.). Once under the M. A., the downward movement usually gains momentum as both the Industrial Average and its M. A. drop steadily lower. During the course of a bear market only the most important (usually widely spaced in time) secondary (upward) reactions penetrate above the declining M. A., and these upward penetrations are almost always of short duration.

During all bull swings since the mid-1940's, the Industrial Average has tended to hold above its own 30-week moving average for extended periods of time (often six months to over a year). On occasion a shocking news event (such as the Korean War) will drive the Industrial Average below its M. A., but such penetrations in bull markets are short-lived and are soon followed by the normal bull market relationship of the Industrial Average holding above its own M. A.

In almost every case, a violent Industrial plunge below its M. A., which is not accompanied by any particular adverse news, is a danger signal worth heeding. Such action last occurred in January, 1960 (when the market broke in the face of the steel strike settlement). At these times, the M. A. can be used to best advantage in conjunction with Dow's 50% Principle (see Letter 151).

In reviewing the action of 1960 (see chart), it is worth noting that the Industrial Average seemed to "cling" to the area of its M. A.,



never falling more than 50 points below the M. A. line. In September and October, 1960, the Industrial Average appeared to be poised for another downward plunge, but the 550 (or 50%) level was never violated (see Letters 130 and 151).

When the first disastrous post-war bear market is upon us, the following sequence of events will probably occur: (1) A bear signal will be given as preceding secondary lows are violated by both Averages, (2) The Industrial Average will plunge through its own 30-week M. A. (3) The 50% level (halfway from 566.05 to whatever high is finally established) will be shattered.

On the most recent decline which took the Industrial Average to the July 18 low of 679.30, the senior Average halted just 9 points above its M. A. (while volume dropped to about half that which occurred during March and April). Following this, the Industrial Average turned violently upward. Hamilton once wrote: "It is reasonably certain that a market smash cannot be brought about unless an edifice of speculation has been constructed sufficiently high to make a noise when it topples over." So far, on every major decline since 1946, the "noise" to which Hamilton referred has been conspicuously absent. (Note: the M. A. on the D-J Industrial Average now stands at 677).

LOW-PRICED STOCK INDEX (L-P Stock Index) Periodically, these Letters review the action of the low-priced stocks (commonly known as "cats-and-dogs"). The classic low-priced issues, represented by Barron's or Standard & Poor's L-P Stock Indexes, should not be confused with the "new issues" which have been flooding the market over the last year. Actually, there have been only three real "new issue markets" in this generation; these were 1927-29, 1945-46 and 1960-61. The classic low-priced stocks, however, are the issues such as Coty, Hupp Corp., Sparton Corp., Baldwin-Lima and Libby-McNeill. These stocks have been around a long time, and they traditionally go into their "explosive act" towards the end of a bull market. Normally, they will register their bull market peaks anywhere from a few weeks to many months ahead of the final peak on the D-J Industrial Average. Subsequently, the L-P stocks drop back into oblivion to wait perhaps years for the next bull market "blow-off".

The accompanying chart shows the movements of the D-J Industrial Average superimposed on Barron's L-P Stock Index since 1954. Here we see the top (250) touched by the L-P Index in April, 1959. Nine months later the Industrial Average recorded its peak of 685.47 (January, 1960). Following the 1960 drop, both indicators touched lows in the autumn of 1960, from whence a new advance began. At that time I wrote that all history suggests that once the L-P Stock Index completes its "new era" surge and turns down, that Index does not rally above the previous peak again.

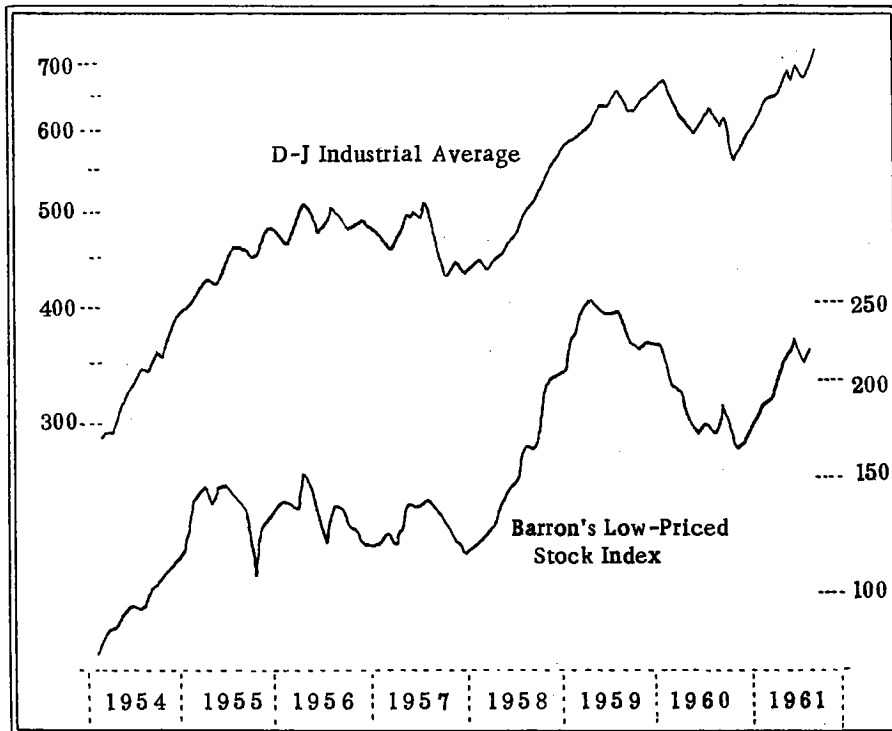
In April, 1961, the D-J Industrial Average bettered its previous all-time high of 685.47. In view of this it is worth noting that in June, 1961, Barron's L-P Index rallied to 225 (25 points under its April, 1959 peak). Since June Barron's L-P Index has fluctuated in the 210 to 220 area, but it has not approached the 1959 high of 250.

What does this strange relationship mean? I would say that if Barron's L-P Index surges to a new high (above 250), the indication will be that the current upsurge has considerably further to go. However, if Barron's L-P Index now drops to, or below, the 1960 low, then the market is living on borrowed time, and the Industrial top should be shortly seen (if it has not already been seen).

STOCKS Five of the seventeen stocks in our "continuing study group" are under their 30-week moving average (M. A.). This represents no change from the last Letter.

Alcoa is looking considerably stronger, and a rally to 80 would represent an upside "breakout". Short interest in AA has declined for six consecutive months. Despite this a move to 80 would be a "buy signal" for AA. (M. A. is now 73 7/8).

Two weeks ago General Electric finally bettered its M. A. (which now stands at 65 3/8). Thus



the stock appears to be in a better position than at any time since 1960. Those who bought it near the lows (see Letter 141) have 5 or 6 points to show for their patience; a rise above 70 could take G.E. to the 80 area.

Eastman Kodak is still below its M. A. of 110. Leave it alone unless it can rally into the 112 area.

New York Central "tested" its 1960 low of 14 3/4 and held. CN is still under its M. A. of 18 1/4. If the Rail Average betters its recent peak of 142.48 I would not be adverse to buying CN as a speculation. (Note: Southern Pacific, repeatedly recommended, has been the "star" of the Rail group. Last week it rallied to an all-time high).

Goodyear has been recommended repeatedly in these Letters, and readers who purchased GT must now have reasonable profits. Although Goodyear is holding well above its M. A., I do not like the declining trend in its short interest (see chart). I would be willing to cash in half of my profits in Goodyear. (M. A. on GT is now 39 3/8).

I have shown a long-term weekly chart of Schering. The stock dropped from a 1960 high of 82 to a 1960 low of 42, a loss of roughly 40 points. Dow's 50% Principle is of interest here. The stock has formed an inverse "head-and-shoulders" reversal pattern just under the halfway point of the entire 1960 decline. Schering recently broke to the upside above the 50% level, and this opens the possibility of a further advance towards the highs. SRG should be a good speculation on any dip, given a reasonably good general market. (Chart of Schering courtesy of Traders Research, P.O. Box 6185 Lambert Airport, Mo.)

ARRIVAL AND DEPARTURE: Due to a personal tragedy involving my youngest daughter, I now find it imperative to move to the best and most agreeable climate that I can find. Considering climatic conditions and medical facilities (as well as availability of stock market information), I have chosen the area of San Diego, California. I am in the process of moving my family and my business to the West Coast, and it will be from there that all future Letters will be mailed. From experience I find that the market information which I need is as readily obtainable in San Diego as in New York. The Wall Street closings come out at 12:30 P.M. (three hours earlier), and the evening papers therefore give more complete market statistics than do the New York night papers. The Wall Street Journal is now printed in San Francisco and is delivered daily to San Diego, and within a few months a second W. S. J. plant will be in operation in Los Angeles. Californians may be interested to learn that the New York Times will be available (printed almost simultaneously, electronically) on the Coast within a matter of months. In closing, I might add that the character of these Letters should remain the same, while the greater distance from Wall Street and the "rumor mills" may provide a more objective approach. East Coast subscribers who have been receiving the Letters by regular mail will now receive them via airmail. The next Letter should go out within eight to ten days, but from then on things will be back to normal. (The new mailing address for Dow Theory Letters will be P.O. Box 15196, San Diego 15, California. The actual office address will be 4957 68th Street, San Diego 15, California.)

(Written: August 16th - 12 P.M.)

